Supreme Court, U.S.
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No. 08-838

In The Supreme Court of the United States

NAVEEN JAIN and ANURADHA JAIN,

Petitioners,

v.

J.P. MORGAN SECURITIES INC., WILSON SONSINI GOODRICH & ROSATI, P.C. and PERKINS COIE, LLP,

Respondents.

On Petition For A Writ Of Certiorari To The Court Of Appeals For The State Of Washington

RESPONDENT J.P. MORGAN SECURITIES INC.'S BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Under Section 16(b) of the Securities Exchange Act of 1934, a corporate insider, who both purchases and sells the corporation's stock within a specified period, must disgorge all profits from the transactions. The statute is specifically intended to deprive the insider of such profits.

The question presented is whether Section 16(b) preempts the insider's state-law indemnity claim to regain the forfeited profits.

RULE 29.6 STATEMENT

Pursuant to Supreme Court Rule 29.6, J.P. Morgan Securities Inc. states that it is a wholly-owned subsidiary of JPMorgan Securities Holdings LLC, which is a wholly-owned subsidiary of JPMorgan Chase & Co., a public company. No publicly held company owns 10% or more of JPMorgan Chase's stock.

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OTHER PROVISIONS INVOLVED

In addition to Section 16(b) of the Securities Exchange Act of 1934 (quoted at Petition 2-3), this case involves Article VI, clause 2 of the United States Constitution. It provides that federal law "shall be the supreme Law of the Land; . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2.

STATEMENT OF THE CASE

This is an indemnity action arising out of an underlying federal-court judgment against Petitioners under Section 16(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78p). Under Section 16(b), a corporate insider who sells and purchases (or purchases and sells) the company's stock within a six-month period must forfeit to the corporation all profits from the purchase and sale. Such profits are known as "short-swing" profits. Congress specifically enacted this law to deprive insiders of all profit from such transactions, as a blunt but effective method of eliminating the incentive for transactions it deemed especially susceptible to abuse. Pp. 9-11, 18-20 below.

As detailed below, the district court in the underlying case found that Petitioners had engaged in purchases and sales within a six-month period. It compelled Petitioners to disgorge their profits as Section 16(b) required. Petitioners subsequently brought the current indemnity action in Washington

state court, trying to force Respondents to reimburse the profits that Petitioners had disgorged.

I. THE UNDERLYING SECTION 16(b) JUDGMENT AGAINST PETITIONERS; FINDINGS OF UNDISPUTED FACT.

Petitioners are Naveen Jain and his wife Anuradha Jain. Mr. Jain was the founder, Chairman of the Board of Directors, and CEO of a corporation called InfoSpace. In 2001, an InfoSpace shareholder brought a derivative action against Petitioners on behalf of InfoSpace in the United States District Court for the Western District of Washington. The action sought to compel Petitioners to disgorge to InfoSpace Petitioners' profits on short-swing sales of InfoSpace stock, under Section 16(b). No recovery was sought under any other federal securities law.

The Section 16(b) Action against Petitioners concerned two sets of transactions by which Petitioners acquired shares in InfoSpace from trusts that Petitioners had established for tax purposes. *See* Petition ("Pet.") A-62-63. Contrary to the petition's representations, Petitioners were not innocent lambs caught up in these transactions solely as a result of others' actions. These assertions were squarely raised and resolved against Petitioners in the Section 16(b) Action.

The first transaction occurred when InfoSpace demanded that Mr. Jain "personally indemnify the company" for certain claims by "placing one million

shares of his InfoSpace stock in escrow." Pet. A-63. Mr. Jain took one million InfoSpace shares from one of the trusts, and placed them in escrow. Pet. A-63-64. The district court found that this transaction was a purchase under Section 16(b). Pet. A-78.

The petition for certiorari incorrectly represents that "no such escrow was ever established" and advises that it is a "verity" that Petitioners did not know of the transactions that created it. Pet. 4, 6, 9, 16. The district court found precisely the opposite in entering summary judgment against them in the underlying 16(b) case. Pet. A-78-80.

Specifically, the court found that Mr. Jain himself "executed an indemnification agreement to establish the escrow fund." Pet. A-78-79. The court found that there was an "escrow agreement between Mr. Jain and InfoSpace" that "reflects the encumbrance and transfer of the personal property of one million shares," and it "is clear that the parties intended and agreed to encumber the personal property and establish an escrow." Pet. A-79-80. Besides personally signing the escrow agreement, Mr. Jain also "personally signed SEC filings representing that he had placed shares into escrow." Pet. A-55; *accord* Pet. A-64, A-80. Mr. Jain even "requested that the Board release the escrowed shares" once the one-year escrow period was over. Pet. A-64. Having personally signed the escrow agreement, represented to the SEC that the shares were escrowed, and later requested release of the escrowed shares, Mr. Jain obviously knew about the escrow. And the district court unequivocally

found that these acts "formed an escrow" under Washington law. Pet. A-80.

The court's findings also make clear that Mr. Jain personally benefited by escrowing the trust's shares rather than his own. He "avoided pledging stock he already owned, thereby gaining an opportunity to trade a million shares that otherwise would have been encumbered." Pet. A-80. He also "incurred no risk that the one million shares from the [trust] would decrease in value, since he did not pay for the shares . . . ." Pet. A-80.

Based on these facts, the district court found that "Mr. Jain's placement of [trust] shares into an escrow account . . . was voluntary . . . ." Pet. A-78. The district court further found that this "transfer of stock from the [trust] to an escrow account to satisfy a personal obligation of Mr. Jain effected a change in beneficial ownership" and that it "created the possibility of speculative abuse." Pet. A-71, A-77-78. Accordingly, it found, "he [Mr. Jain] effected a purchase for purposes of liability under Section 16(b)." Pet. A-80.

The other transactions at issue in the Section 16(b) Action concerned the transfer of shares from trust accounts to Petitioners' personal account following an InfoSpace stock split (the "split-share transactions"). Pet. A-64-66. As with the escrow transaction, Petitioners' representations that they were unaware of the actions that created the split-share transactions cannot be reconciled with the district court's findings against them in the underlying case. The

district court expressly found that Petitioners voluntarily participated in these transfers and that the transfers would not have happened without Petitioners' participation. Pet. A-76-77, A-80.

Specifically, Petitioners acquired the shares of three trusts. As to two of these trusts, Petitioners *personally signed* a letter of authorization "gift[ing]" the trusts' new shares to themselves personally. Pet. A-65. Petitioners sent this letter to their personal broker, Hambrecht & Quist ("H&Q").[1] Pet. A-65. H&Q accordingly deposited these shares into Petitioners' personal accounts. Pet. A-65. The district court emphasized in awarding prejudgment interest that "[t]he Jains transferred shares to their personal accounts by signing letters of authorization . . . ." Pet. A-55.

The district court also found that Petitioners voluntarily participated in deposit of the third trust's new shares to their personal account. When Petitioners received this third trust's new InfoSpace stock certificates, Petitioners did not send the certificates to Banc of America, where the *trust's* accounts were held. Pet. A-65. Petitioners sent the certificates to their *personal* broker at H&Q. Pet. A-65. H&Q consequently deposited these shares in Petitioners' personal account. Pet. A-65 (emphasis added).

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[1] Hambrecht & Quist is predecessor in interest of Respondent J.P. Morgan Securities Inc.

As with the escrow transaction, the district court expressly found that the "Jain Defendants' actions were voluntary." Pet. A-76. It further found that Petitioners "caused deposits of trust stock into their personal brokerage accounts by forwarding stock certificates to their personal broker," and they "signed papers allowing transfer of funds from [certain trusts]." Pet. A-76. Thus, Petitioners "participated in the transfers and retained more than a degree of control over the transactions. Without the participation of the Jains, the transfers would not have happened." Pet. A-76-77.

Further, the court found, the transfers "created the possibility of speculative abuse." Pet. A-77. For example, Petitioners could have sold the shares at a high price, repurchased at a lower price, pocketed the difference and returned the shares to the trusts. Pet. A-77. Because Petitioners' transfer of trust shares to their personal accounts constituted a change in beneficial ownership, was voluntary, and created the possibility of speculative abuse, the court found they were "purchases for purposes of Section 16(b) liability." Pet. A-78.

Completing the last link in the Section 16(b) inquiry, the district court also found that Petitioners sold InfoSpace shares within six months of these transactions. Pet. A-51, A-6. Because Petitioners had purchased and sold InfoSpace stock within six months, they were required to disgorge their profits under Section 16(b). The district court found that the Petitioners' profit was the difference between the

amount they paid for the shares ($0) and the amount they realized in the sale, over $200 million. Pet. A-51.

The district court accordingly entered judgment against Petitioners and in favor of InfoSpace for just over $200 million, the amount of the profit. Pet. A-58. The court also awarded prejudgment interest, finding that Petitioners had not established that they acted in good faith in connection with the transactions. Pet. A-55-56, A-59. Petitioners appealed. Pet. A-7. While the case was on appeal, they settled and agreed to pay InfoSpace $65 million for the Section 16(b) claim. They subsequently dismissed their appeal. The judgment is final and not subject to any further review.

II. PETITIONERS' INDEMNITY ACTION.

Following entry of judgment against them in the Section 16(b) Action, Petitioners filed this action in Washington state court. Their current operative complaint alleges claims against Respondents J.P. Morgan Securities Inc., as successor in interest to Hambrecht & Quist; Wilson Sonsini Goodrich & Rosati (JP Morgan's counsel); and Perkins Coie, LLP (InfoSpace's counsel). Petitioners' complaint seeks to recover the amounts that Petitioners paid to settle the Section 16(b) Action, litigation costs such as attorneys' fees incurred in the Section 16(b) Action, and supposed consequential damages from having to pay those litigation costs. It does so on various tort theories such as negligence, breach of fiduciary duty,

equitable apportionment, "recovery of non-settlement damages," and equitable indemnity.

After repeated amendments of Petitioners' complaint, the trial court dismissed the complaint against each Respondent without leave to amend. Pet. A-21, A-25, A-29.

The Washington Court of Appeals affirmed. In accord with every reported case to address the issue, it held that an insider compelled to forfeit profits under Section 16(b) may not obtain indemnity. Such indemnity, the court explained, would frustrate federal law by restoring the profits Congress had deliberately taken away. Pet. A-15. The court also held that all of Petitioners' claims against Respondent JP Morgan are either indemnity or de facto indemnity claims and are barred by the policy against indemnity for Section 16(b) claims. Pet. A-15-16.

Last – and independent of preemption – the Washington Court of Appeals held that because Petitioners' own conduct caused the transactions that made them liable under Section 16(b), as a matter of state law they cannot recover attorneys' fees and other litigation expenses from the 16(b) Action. Washington law does not allow a party whose "own conduct caused it to be 'exposed' or 'involved' in litigation" to recover indemnity for fees and costs from that litigation. Pet. A-17. This is called the ABC rule. Pet. A-16-17. Quoting the district court's findings of undisputed fact set forth above, the Court of Appeals held that "[t]he Jains were not blameless in the transactions

giving rise to their liability." Pet. A-17. Accordingly, "[w]e hold that the Jains' own conduct caused them to be involved in the litigation and, therefore, under the ABC rule they may not recover fees or litigation costs." Pet. A-18.

The Washington Supreme Court denied Petitioners' petition for discretionary review. Pet. A-2. Petitioners then filed their petition for certiorari.

REASONS FOR DENYING THE PETITION

I. ALL LOWER COURTS AGREE THAT SECTION 16(b) PREEMPTS INDEMNITY CLAIMS LIKE PETITIONERS'.

As this Court explained in *Reliance Electric Company v. Emerson Electric Company*, 404 U.S. 418, 422, 92 S. Ct. 596, 30 L. Ed. 2d 575 (1972), Congress enacted Section 16(b) "to curb the evils of insider trading [by] . . . taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great." Thus, Congress deliberately deprived short-swing traders of profits under Section 16(b). Allowing them to obtain indemnity under state law would restore those profits to them, frustrating Section 16(b)'s purpose.

Accordingly, the only two appellate decisions on the issue – the decision below and *First Golden Bancorporation v. Weiszmann*, 942 F.2d 726, 729 (10th Cir. 1991) – both hold that Section 16(b) preempts state-law indemnity claims to recover the

profits disgorged under Section 16(b). Petitioners concede that "[t]he Tenth Circuit is the only Court of Appeals that has addressed the indemnification issue in the context of liability imposed by 16(b)." Pet. 24 (citing *First Golden*). That Tenth Circuit decision unambiguously holds such claims preempted: "[W]e hold that the public policy behind section 16(b) renders invalid any attempt by an insider to seek indemnification for his liability under section 16(b)." *First Golden,* 942 F.2d at 729.

Decisions of federal district courts and state lower courts – if relevant at all, *see* Supreme Court Rule 10(a)-(b) – tell the same story. Every court that has addressed the issue has held that state-law indemnity claims, to recover the profits taken away by Section 16(b), are preempted:

- "[T]he Court is persuaded that allowing indemnification for § 16(b) violations would frustrate the public policy behind the statute because liable parties would not have to return their short-swing profits to the plaintiff issuer." *Schaffer v. CC Investments, LDC*, 286 F. Supp. 2d 279, 283 n.6 (S.D.N.Y. 2003).

- "[If] indemnification is found to be valid, then the defendants would have been able to waive, in effect, the requirement of section 16(b). . . . This result would frustrate the public policy behind the prohibition of insider trading within the six-month time period found in section

16(b)." *Bunker Ramo-Eltra Corp. v. Fairchild Indus., Inc.*, 639 F. Supp. 409, 419 (D. Md. 1986).

- "[I]ndemnity for section 16(b) violations would undermine the deterrent purpose of section 16(b) by allowing a wrongdoer to recoup its disgorged profits." *Deephaven Capital Mgmt., LLC v. Schnell*, No. 06-844 (JRT/FLN), 2007 WL 101821, at *3 (D. Minn. Jan. 8, 2007).[2]

Thus, there is nothing to review. All courts to reach the issue agree that indemnity for Section 16(b) liability would frustrate Congress' purpose and is preempted. The scarcity of cases addressing the issue also confirms that it is not of widespread interest.

With no basis to review the issue actually raised by this case, Petitioners try to manufacture a conflict over whether indemnity is consistent with "federal securities laws" generally when "the securities statute" is supposedly satisfied. Pet. i. That question is not even raised by this case. Section 16(b), whose specific objective is to deprive short-swing traders of profits, *see Reliance*, 404 U.S. at 422, would by definition not be "satisfied" if those profits were restored.

But putting that aside, there is no conflict as to whether federal securities laws preempt state-law indemnity claims, even outside the Section 16(b)

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[2] No state appellate court has addressed the issue, besides the courts below.

setting. Not a single federal court of appeals or state court of last resort, including those cited by Petitioners, has allowed a violator of any federal securities law to pursue an indemnity claim. If anything, Petitioners' cases underscore the correctness of the decision below.

For example, *Globus v. Law Research Service, Inc.*, 418 F.2d 1276, 1288 (2d Cir. 1969), held that it "would be against the public policy" of the Securities Act of 1933 to allow indemnity. The court reasoned, among other things, that civil liability under that Act was designed to "deter negligence by providing a penalty," and that the "'*in terrorem* effect' of civil liability . . . might well be thwarted if underwriters were free to pass their liability on . . . ." 418 F.2d at 1288. Thus, *Globus* arises under a different securities law, and if on point at all, it agrees, not conflicts, with the decision here. Petitioners vainly try to gin up a conflict by pointing to *Globus*'s statement that it considered only the facts before it, involving conduct graver than ordinary negligence. Pet. 19. But stating that the court is only considering the facts before it does not remotely establish a contrary rule for different facts not before the court. It certainly does not create a conflict with other cases on those supposedly different facts.

Petitioners' other court of appeals cases similarly agree with the result here. All of Petitioners' court of appeals cases addressing state-law indemnity claims hold them *preempted*. *See Baker, Watts & Co. v. Miles & Stockbridge*, 876 F.2d 1101, 1105 (4th Cir. 1989)

(holding that the federal policy against indemnification for securities violations preempted state law indemnity claim); *Heizer Corp. v. Ross*, 601 F.2d 330, 334 (7th Cir. 1979) (holding that indemnification is preempted because it would "frustrate and defeat" the policy of securities legislation); *Laventhol, Krekstein, Horwath & Horwath v. Horwitch*, 637 F.2d 672, 676 (9th Cir. 1980) (affirming dismissal of an indemnity claim because it would "undermine the statutory purpose" of the securities laws); *Eichenholtz v. Brennan,* 52 F.3d 478, 484 (3d Cir. 1995) (holding that indemnification claims "run counter" to securities law policies and are barred, even if party seeking indemnification was "merely negligent, played a 'de minimis' role . . . or was being held derivatively or vicariously liable").[3] Petitioners' other two cases do not even involve state-law claims for indemnity, and they *deny* any right to indemnification under federal law. *In re U.S. Oil & Gas Litig.*, 967 F.2d 489, 495

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[3] Petitioners note that *Eichenholtz* stated that one defendant, First Jersey, would be able to recover from its agent, Brennan, if First Jersey were held vicariously liable. 52 F.3d at 485 n.13; *see* Pet. 28-29. That has nothing to do with this case. As Petitioners recognize, the district court there, as part of a settlement, had barred claims only against *settling* defendants. Pet. 27-28. Claims against Brennan were not barred "because Brennan is a *non*-settling defendant." 52 F.3d at 485 n.13 (emphasis added). *Eichenholtz* did not allow a party held vicariously liable to obtain indemnity. To the contrary, it expressly held that state-law indemnity claims are preempted even if the party seeking indemnity was "being held derivatively or vicariously liable." 52 F.3d at 484.

(11th Cir. 1992); *King v. Gibbs,* 876 F.2d 1275, 1276 (7th Cir. 1989). None of these cases allows a violator of Section 16(b) or any other federal securities law to obtain indemnity.[4]

Apparently recognizing that their asserted court of appeals conflict is illusory, Petitioners cite district court cases. An asserted conflict with district courts, however, does not warrant this Court's review. *See* Supreme Court Rule 10(a)-(b). In any event, Petitioners' district court cases are off point.[5]

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[4] *Baker, Watts, Heizer* and *Eichenholtz* allow contribution claims in some circumstances. Petitioners here cannot state a contribution claim, as they acknowledge. Pet. 37. Contribution lies only against joint tort-feasors. *All-Pure Chemical Co. v. White,* 127 Wn.2d 1, 4, 896 P.2d 697 (1995) (Washington law "provides for the right of contribution only among 'two or more persons who are jointly and severally liable' ") (quoting RCW 4.22.040(1)). Respondents cannot be joint tort-feasors because Respondents, who did not purchase or sell InfoSpace stock, could not have violated Section 16(b). Pet. 37.

[5] None of Petitioners' district court cases presents a fact situation similar to this case. Petitioners' cases involved (1) a plaintiff seeking indemnity who did not have a judgment entered against it and thus would have an opportunity to prove it was completely without fault, *see Fromer v. Yogel,* 50 F. Supp. 2d 227 (S.D.N.Y. 1999); *Greenwald v. American Medcare Corp.,* 666 F. Supp. 489 (S.D.N.Y. 1987); (2) indemnity *voluntarily* agreed to, *see Raychem Corp. v. Fed. Ins. Co.,* 853 F. Supp. 1170 (N.D. Cal. 1994) and *Cambridge Fund, Inc. v. Abella,* 501 F. Supp. 598 (S.D.N.Y. 1980) (consent order); (3) contribution-type claims against a party who, unlike Respondents here, allegedly violated the securities laws, *see Arden Way Associates v. Boesky,* 664 F. Supp. 863 (S.D.N.Y. 1987); or (4) state-law claims seeking more than plaintiffs' settlement payments and

(Continued on following page)

Petitioners protest that the established no-indemnity rule is unjust, and that they should not be made to lose their profits under Section 16(b) solely through the actions of others. *See* Pet. 15-17. They are far off base, and this case would be a poor vehicle to test any such contention. As detailed above, the district court found that Petitioners personally executed the agreement that created the escrow, personally signed SEC filings stating that the shares had been placed in escrow, personally signed letters "gifting" trust shares to their personal accounts, and personally sent trust share certificates to their personal broker. Pp. 2-6 above. That is how Petitioners came to acquire the trusts' shares, triggering Section 16(b). The district court found that all of these transactions were voluntary, personally benefited Petitioners, and would not have happened without Petitioners' actions. It further found that Petitioners' voluntary transactions created the very possibility for speculative abuse that Section 16(b) was meant to prevent. P. 6 above.

These findings of undisputed fact are fatal even at the pleading stage, as the court below implicitly recognized. It expressly relied on the district court's findings, holding that state law barred Petitioners' claim for attorney fees and litigation costs because "the Jains' own actions caused them to run afoul of

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litigation expenses. *In re Cendant Corp. Sec. Litig.*, 139 F. Supp. 2d 585 (D.N.J. 2001); *In re Sunrise Sec. Litig.*, 793 F. Supp. 1306 (E.D. Pa. 1992).

section 16(b)." Pet. A-17. Indeed, under Washington law, Petitioners must demonstrate that they were *liable* for the Section 16(b) claim before they can even state an indemnity claim. *See Gilbert H. Moen Co. v. Island Steel Erectors, Inc.*, 128 Wn.2d 745, 763-64, 912 P.2d 472 (1996) (party seeking indemnity after settlement must prove that it was liable for underlying claim); *United Boatbuilders, Inc. v. Tempo Products Co.*, 1 Wn. App. 177, 181, 459 P.2d 958 (1969) (same). They cite no authority suggesting they can admit liability while denying the central findings that establish that liability.[6] In addition, the district court's findings were necessary to both the liability judgment and the decision to award prejudgment interest as part of the judgment. Pet. A-55 (relying on Petitioners' voluntary participation in transactions to impose prejudgment interest), A-76-81 (relying on Petitioners' voluntary participation and formation of escrow account to find liability). Thus Petitioners are collaterally estopped to deny them, as Respondents JP Morgan and Wilson Sonsini emphasized in the courts below. *See Parklane Hosiery Co., Inc. v. Shore,*

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[6] Respondent Perkins Coie's causation argument in connection with Petitioners' malpractice claim applies equally to Petitioners' indemnity claims against JP Morgan. Petitioners allege that JP Morgan's purported wrongdoing was the cause of the judgment against them in the Section 16(b) Action. However, the Washington Superior Court found that the judgment against Petitioners was in error and would have been reversed by the Ninth Circuit. Therefore, the district court's error and the Ninth Circuit's reversal break the chain of causation between JP Morgan's actions and Petitioners' alleged damages.

439 U.S. 322, 99 S. Ct. 645, 58 L. Ed. 2d 552 (1979); *Blonder-Tongue Laboratories, Inc. v. University of Illinois Foundation,* 402 U.S. 313, 329, 91 S. Ct. 1434, 28 L. Ed. 2d 788 (1971) (non-party to prior case may assert collateral estoppel against party who lost that case); *Duncan v. Judge*, 43 Wn.2d 836, 843, 264 P.2d 865 (1953) (defendant found jointly responsible with another defendant for accident could not seek indemnity from other defendant on the theory that the other defendant was solely responsible).

In sum, this case does not warrant this Court's review. Only a handful of cases have addressed whether a party forced to disgorge profits under Section 16(b), like Petitioners, can maintain an indemnity action to recover them. Every one holds that they cannot. Petitioners cite no case from a state court of last resort or federal court of appeals, under *any* federal securities law, allowing a state-law indemnity claim on parallel facts. There is nothing to review.

II. THE DECISION BELOW IS CORRECT ON THE MERITS – PETITIONERS' STATE LAW INDEMNITY CLAIMS ARE DIRECTLY CONTRARY TO SECTION 16(b), AND ARE BARRED BY THE SUPREMACY CLAUSE.

The decision below is also correct.

Article VI of the Constitution provides that federal law "shall be the supreme Law of the Land;

. . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. Const. art. VI, cl. 2. Federal law preempts state law where, *inter alia,* state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" or is "contrary to" federal law. *Geier v. American Honda Motor Co., Inc.*, 529 U.S. 861, 873, 881-82, 120 S. Ct. 1913, 146 L. Ed. 2d 914 (2000) (quoting, in part, *Hines v. Davidowitz,* 312 U.S. 52, 67, 61 S. Ct. 399, 85 L. Ed. 581 (1941)).

A state-law indemnity claim would stand as just such an obstacle, indeed run directly contrary, to Section 16(b). Congress' intent in enacting Section 16(b) was to take the profits out of a class of transactions in which it determined the possibility of abuse of inside information was intolerably high. *Reliance Elec. Co.*, 404 U.S. at 422. To effectuate this purpose, Congress created a hard and fast rule: All profits any insider made as a result of any purchase and sale, or sale and purchase, within a six-month period, must be forfeited.

> The objective standard of Section 16(b) imposes strict liability upon substantially all transactions occurring within the statutory time period, regardless of the intent of the insider or the existence of actual speculation. This approach maximized the ability of the rule to eradicate speculative abuses by reducing difficulties in proof. Such arbitrary and sweeping coverage was deemed necessary to insure the optimum prophylactic effect.

Reliance Elec. Co., 404 U.S. at 422 (quoting *Bershad v. McDonough*, 428 F.2d 693, 696 (7th Cir. 1970), *cert. denied*, 400 U.S. 992 (1971)).

Allowing indemnity for Section 16(b) violations, and thereby permitting insiders to keep the profits from their short-swing sales, would defeat the purpose of Section 16(b), presenting an obstacle to it. That is why every court that has addressed the issue, including the courts below, has denied indemnity claims for Section 16(b) violations. *See* pp. 8-9 above. Indeed, the Court of Appeals reviewed the case law on Section 16(b) indemnity claims and found "[i]t is well settled that an insider found to have violated section 16(b) may not seek indemnification for the ensuing liability. This is to prevent an insider from effectively waiving the requirement that short-swing profits be returned, thus frustrating the policy behind section 16(b)." Pet. A-10 (citing *First Golden Bancorporation*, 942 F.2d at 728-29; *Bunker Ramo-Eltra Corp.*, 639 F. Supp. at 418-19; *Schaffer*, 286 F. Supp. 2d at 283).

As noted above, Petitioners do not, and cannot, cite a single case permitting indemnity for a Section 16(b) violation. Instead, they misleadingly argue that their claims should have been upheld under a standard "allowing claims of indemnification by innocent, or merely negligent, defendants accused of violating the federal securities laws." Pet. 19. But that purported standard does not exist. No appellate court has allowed a defendant accused of violating the securities laws to pursue an indemnity claim. Instead, the courts that have addressed the issue,

including those cited by Petitioners, generally hold that indemnity is not available for any securities law violations. *See, e.g., Eichenholtz*, 52 F.3d at 484 ("We agree with those courts that have held that there is no implied right to seek indemnification under the federal securities laws."); *Baker, Watts*, 876 F.2d at 1105 ("[A] right of action for indemnification would frustrate the statute's goal of encouraging diligence and discouraging negligence in securities transactions."); *King*, 876 F.2d at 1282 n.10 ("It is difficult to see how a right to indemnification for even innocent persons would serve the deterrent function which underlies the statute."); *Stowell v. Ted S. Finkel Inv. Services, Inc.*, 641 F.2d 323, 325 (5th Cir. 1981) ("[I]t may be noted that indemnification tends to frustrate the policy of securities legislation."); *Laventhol*, 637 F.2d at 676 ("[T]he purpose of the Act is regulatory rather than compensatory, and permitting indemnity would undermine the statutory purpose of assuring diligent performance of duty and deterring negligence."); *Riverhead Sav. Bank v. Nat'l Mortgage Equity Corp.*, 893 F.2d 1109, 1116 (9th Cir. 1990) ("Indemnification is not available under federal securities laws.").

Even beyond the general unavailability of indemnity under federal securities laws, the policies behind Section 16(b) make it particularly unsuitable for indemnity claims. Even the Southern District of New York, which Petitioners rely on to argue that indemnity claims have been allowed in some securities fraud actions, *see* Pet. 19, n.2, has noted that

allowing a Section 16(b) violator to pursue an indemnity claim would be contrary to the policies behind Section 16(b):

> The Second Circuit has suggested that indemnity claims under the Act may proceed where the wrong committed by those seeking indemnity is no greater than ordinary negligence. *See Fromer v. Yogel*, 50 F. Supp. 2d 227, 238 n.8 (S.D.N.Y. 1999). However, the Second Circuit has not dealt directly with indemnity claims by parties prosecuted under § 16(b), and as this Court has acknowledged, several other Circuits suggest or hold that indemnity is simply unavailable under the federal securities laws. *See id.* at 238 n.8. **Moreover, the Court is persuaded that allowing indemnification for § 16(b) violations would frustrate the public policy behind the statute because liable parties would not have to return their short-swing profits to the plaintiff issuer.** *See Bunker Ramo-Eltra Corp. v. Fairchild Industries, Inc.*, 639 F. Supp. 409, 418-19 (D. Md. 1986) (finding that indemnification clause in stock purchase agreement did not indemnify defendants against § 16(b) action).

Schaffer, 286 F. Supp. 2d at 283 n.6 (emphasis added).

Petitioners' other cases are off point. For example, *Musick, Peeler & Garrett v. Employers Insurance of Wausau*, 508 U.S. 286, 113 S. Ct. 2085, 124

L. Ed. 2d 194 (1993), allows a defendant in a securities fraud claim under Rule 10b-5 to bring a contribution claim under federal law. Petitioners admittedly cannot state a contribution claim here, however. *See* p. 14 n.4 above. *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 93 S. Ct. 1736, 36 L. Ed. 2d 503 (1973), and *Foremost-McKesson, Inc. v. Provident Securities Co.*, 423 U.S. 232, 96 S. Ct. 508, 46 L. Ed. 2d 464 (1976), did not authorize, or even address, indemnity claims. They construed the scope of liability under Section 16(b). But the scope of Petitioners' liability is not at issue. Petitioners' liability was conclusively established in the underlying Section 16(b) Action; besides, Petitioners cannot state an indemnity claim under Washington law unless they *admit* Section 16(b) liability. P. 16 above.

Petitioners assert that their settlement with InfoSpace fulfilled the purposes of Section 16(b) because their profits (or at least a portion of them) were returned to the issuer. But the effectiveness of Section 16(b) depends on taking away profits from insiders, not on where those forfeited funds go. *See Reliance Elec. Co.*, 404 U.S. at 422 (Congress enacted Section 16(b) to take "profits out of a class of transactions"); *Deephaven Capital Mgmt., LLC*, 2007 WL 101821, at *3 (indemnity claim would undermine purpose of Section 16(b) "by allowing a wrongdoer to recoup its disgorged profits").

Schaffer, *First Golden*, *Deephaven*, and *Bunker Ramo-Eltra* govern this case and the Court of Appeals'

opinion is in accord with these decisions. Pet. A-10-14.

The Court of Appeals was also correct in affirming the dismissal of all of Petitioners' claims as "de facto indemnity claims." Pet. A-16. In *First Golden*, the party seeking indemnity for a Section 16(b) claim also brought other claims, including claims for Section 10(b) liability, controlling person liability and negligent misrepresentation. The *First Golden* court held that the party could not avoid the bar against indemnity claims by disguising its indemnity claim as something else. "[T]o the extent that the remaining third-party claims were in reality just disguised indemnity claims for a section 16(b) violation, it would have been appropriate to dismiss them with prejudice." *First Golden*, 942 F.2d at 731. Similarly, the court in *In re Cendant Corp. Securities Litigation*, was quite clear about what should happen to state-law claims that, like Petitioners' claims here, seek to recover damages related to securities liability: "[T]o the extent claims are 'integrally related' with the securities claims that were settled, they would be held to be preempted by the federal securities laws." 139 F. Supp. 2d at 596. Petitioners' claims here, whether entitled indemnity or something else, all seek the same thing: Recovery of Petitioners' settlement payments and litigation expenses relating to the Section 16(b) Action. Consequently, all of Petitioners' claims seek indemnity, are integrally related with the Section 16(b) Action, and are barred.

Last, the Court of Appeals also held that Petitioners cannot recover attorney fees and litigation costs. Besides being correct under the federal law already discussed, this ruling expressly rests on an adequate and independent state-law ground. The Court of Appeals held that Petitioners cannot meet Washington law's requirements for an indemnity claim because their own actions caused the underlying litigation. Pp. 8-9 above. This state-law holding is not subject to review in this Court. *See Michigan v. Long,* 463 U.S. 1032, 1041, 103 S. Ct. 3469, 77 L. Ed. 2d 1201 (1983).

CONCLUSION

The issue presented by this case is whether corporate insiders required to forfeit profits under Section 16(b) can recover those profits through indemnity claims. The lower courts unanimously hold they cannot. There is also no conflict on the broader question Petitioners try to present, whether federal securities laws generally preempt violators' indemnity claims. The court of appeals and state court of last resort decisions addressing such claims have uniformly held them preempted. The decision below

is correct and agrees with established law. The petition should be denied.

Respectfully submitted,

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